Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

REPLY COMMENTS OF SUREWEST COMMUNICATIONS

SUREWEST COMMUNICATIONS

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SureWest Communications ("SureWest") respectfully submits these Reply Comments in response to the Commission's Further Notice of Proposed Rulemaking ("FNPRM") in this proceeding, FCC 05-33, released March 3, 2005.

I. SUMMARY OF COMMENTS

SureWest is a small, publicly-held telecommunications company whose subsidiaries operate almost entirely in Sacramento and Placer Counties, California. SureWest's primary operating subsidiary is SureWest Telephone, an incumbent local exchange carrier (ILEC) that provides approximately 130,000 access lines to customers in and around Roseville, California. SureWest Telephone is the fourth largest ILEC in California, but lacks significant economies of scope and scale – it serves fewer than 0.1% of the nation's ILEC-provided access lines, and fewer than 1% of the ILEC-provided lines in California. In spite of its size, SureWest's subsidiaries are leaders in northern California in providing advanced services – including digital IP-based television, fiber-based CLEC services, DSL, and high-speed Internet services.

The points made in SureWest's initial Comments can be grouped into two general areas: (1) comments on issues of general application to the telecommunications industry and to the handling of intercarrier compensation; and (2) comments on issues that are of unique concern to SureWest in light of its position as a small rate-of-return company that is outside the "rural telephone company" classification.

With respect to the broader industry issues, SureWest made the following major points (a few of which overlap with SureWest-specific issues):

- The record does not support any of the proposed plans in their current form at this time. None of the proposals in their current form fully address the public interest issues present in this proceeding. Some of the plans have elements that are attractive, but each has flaws that are significant. Moreover, none of the proposals has been supported by backup data at a level of detail sufficient to allow for evaluation of their impacts. The lack of such data in the record of this proceeding forms a stark contrast with the detailed record the Commission established when it initially enacted its initial access and price cap rules and related broadly-applicable schemes. A close look at the application of the various plans in the current record calls into question the legal viability of any major revision to compensation rules based on the current incomplete record.

- The Commission should be mindful of the lessons of past decisions in similar proceedings. In such proceedings, the Commission has repeatedly concluded that the public interest requires an allocation of cost recovery among <u>all</u> network users – interconnecting carriers and others who use local networks, as well as end users. In reaching this conclusion, the Commission balanced economic principles that favor recovery of non-traffic-sensitive costs in flat rates against universal service and end user cost recovery impacts.

- Carriers must be allowed a fair chance to recover the costs they must incur in the regulated transport and termination of customer traffic, including the handling of the traffic of other carriers. This concern is based on issues of both law and policy. Regulation that fails to offer carriers a realistic opportunity for cost recovery raises serious "takings" issues. In addition, regulation that limits cost recovery also undermines incentives for broadband deployment and threatens the maintenance of universal service. The bill and keep ("B&K") proposals that are on the record -- including plans that would offer to ILECs compensation rates that are so low that they are the functional equivalent of B&K -- will not provide the realistic opportunity for cost recovery all carriers require, and will put the ILEC networks at risk. Furthermore, forcing rates to a level below related costs can create separate new arbitrage opportunities.

- One guiding principle for any proposed reduction in carrier access rates should be to balance the resulting decline in cost recovery for ILECs with the possibility for additional cost recovery that might come in other ways. This could include modified SLCs, alternative rate elements that operate consistently across customer groups (including a small flat rate originating charge on connections), or an alternative recovery mechanism (or "ARM") that is carefully balanced with usage based rate changes and SLC adjustments. If, as the Commission has stated in the past, its ratemaking scheme is designed to deliver the lowest rates that are still compensatory and not confiscatory, and it has exercised consistent oversight to assure that is true, it should trust the math, particularly for rate of return carriers. It cannot now eliminate one entire source of ILEC revenue without providing a compensating alternative.

- The public interest requires that any revision to intercarrier compensation mechanisms should be accompanied by a revision to federal USF mechanisms. If the Commission moves towards any compensation scheme that involves significant reductions in carrier rates, it will have to address at the same time: (i) broadening the contribution base for federal USF; (ii) tying eligibility for USF support more carefully to all ILECs' actual high cost characteristics; and (iii) dealing with newly-emerging USF issues – including those that arise from this proceeding itself. The Commission also should address the current formula that denies needed assistance to small "non-rural" ILECs like SureWest that operate in states where the largest companies control the calculation of average rates.

- Implementation details need to be addressed carefully. Some of the current proposals for residual support reflect privately-negotiated definitions that are divorced from, rather than reflective of good public policy principles. In addition, they would create recovery arrangements that are in large measure illusory for non-rural rate-of-return carriers, and they would add financial risk for ILECs while simultaneously removing today's strong market-based service incentives.

With respect to issues of direct interest to SureWest, SureWest made the following points:

- Currently-proposed intercarrier compensation changes would be as or more threatening to SureWest's ILEC operations than would be the case for other small rate-of-return regulated ILECs that are able to be treated as "rural telephone companies". As a result, SureWest's customers would be placed at risk.

- As a small ILEC, SureWest's costs are uniquely high, and its avenues for cost recovery today are actually more constrained by existing regulation than are the avenues for rural ILECs. That would continue to be the case under the plans in the current record.

- SureWest would be one of only a handful of small ILECs with high costs and few economies of scope and scale who would be effectively excluded from realistic cost recovery opportunities by some support proposals on the record. This circumstance would disserve core universal service policies and penalize telephone subscribers in SureWest areas.

- Some of the proposals for reform would operate to change SureWest's business from one whose revenues are derived from a diversified base of carriers and other customers to one that divorces SureWest from these customers and that would compensate SureWest, if at all, primarily from transitional residual support mechanisms. Such mechanisms would create an entirely new form of risk for SureWest by eliminating much of its diversified revenue base.

Nothing in the initial round of comments has changed SureWest's views on these issues. Nothing in the comments yet provides the detail sufficient to evaluate the impact of the various ICC proposals on the industry and on residential and other customers and to test alternatives. Nor can one estimate the impacts on the deployment of broadband and other advanced services, or on the average customer's service and its costs.

Thus, while the process of intercarrier compensation could benefit from reform, adoption of any of the proposals in their current form would not only have significant known adverse ramifications for companies like SureWest Telephone and their customers, but it would likely have unknown consequences for other ILECs and their customers. The Commission would not allow a single carrier to file a tariffed rate without cost support; here, the risk is that a rate would be prescribed for an entire industry segment without adequate documentation and analysis of the resulting impacts. In the absence of such documentation, any action to mandate substantial rate reductions would have to be deemed arbitrary and capricious. To the extent that there are known negative consequences that are avoidable, the public interest requires that they be addressed.

It appears that there is yet no plan that provides an optimal set of next steps. SureWest does believe that modification of current intercarrier compensation arrangements, properly done, can serve the public interest. It encourages the Commission to promote continued industry-based discussions before it ventures further. Any plan that is presented to the Commission should be considered suspect if it is unable to generate support from the broad base of ILECs whose customers would be most directly affected.

The remainder of these Reply Comments addresses only a few items identified in the comments of individual parties.

II. THE PLAN OF THE FRONTIER TELEPHONE SUBSIDIARIES OF CITIZENS COMMUNICATIONS.

The plan proposed by the Frontier subsidiaries of Citizens Communications appears to be much like the Expanded Portland Group ("EPG") Plan – a port and link plan (referred to as "transport" and "transiting") that anticipates flash-cut implementation without a transition period. As such, it has the same flaws, described in SureWest's initial Comments. It would be of benefit only to the most rural carriers, with limited points of access to the exchange, and a diverse customer base not easily accessible except through the ILEC. There would be opportunities for gaming since a carrier can move its traffic to fewer transit points, terminating carriers could find call completion alternatives, and significant economic incentives would exist to evade the very points at which the charges would be assessed.

This plan suffers from two additional flaws. One is the accelerated implementation schedule, a schedule that promises dangerous disruptions to carriers and end users.

The second additional flaw is the anticipated bidding process for a single transmission path for transiting that would replace all tandem switching, tandem switched transport, CLEC/CMRS transiting and common transport. This attempt to simplify different transit arrangements by setting up winning bidders as a "monopoly" wholesale transit carrier could force connecting carriers into arrangements that reduce choice and maintain competitive advantages for some providers. It would not be practical in most areas.

III. BELLSOUTH PROPOSAL.

The suggestions made by BellSouth in its Comments offer another serious avenue for further investigation, linking some positive concepts in ways that differ from other plans.

First, BellSouth seeks to avoid any mandatory network architecture changes, and attempts to match cost recovery with cost causation in portions of the existing network architecture. While modifications in intercarrier compensation will no doubt create incentives for network architecture modifications, this plan does not mandate them.

Second, the BellSouth proposal also spreads cost recovery more widely (than the ICF plan, for example) by allowing continued recovery of costs through charges on both carriers and end users. BellSouth would permit an increase in SLC levels that is slightly higher than the levels sought by others, including the ICF plan. SureWest is not confident that even the revenue from higher SLCs could offset the revenue impacts of the low carrier rates suggested by BellSouth, without additional sources of cost recovery. However, in principle, the BellSouth proposal recognizes that a carrier should be compensated by each user of its network. Having some additional contribution to cost recovery from carriers and end users also takes some of the pressure off of an ARM as the only remaining alternative source of cost recovery. Finally, the BellSouth proposal also confirms SureWest's view, stated in more detail in its Comments, that an ILEC's financial risk can be reduced when it can recover needed revenues from *multiple* sources, a circumstance that minimizes the risk of relying on one primary support flow for access revenue shortfalls.

Third, like other plans, BellSouth seeks a more unified approach, coupling the pricing for reciprocal compensation and exchange access into a single mechanism, while recognizing fundamental differences among network elements, carriers and some services. For example, BellSouth maintains a strong boundary between switched and special access, and would apply a small originating access charge to 1+ calls only.

There remains a significant disagreement within the industry over whether there needs to be a uniform *rate*, or whether a rate *structure* that is more rational than the current one, and that can move further toward unity over time (called by some a *unitary rate structure*) will offer on balance more public interest benefits. SureWest believes the latter would better serve the public interest. As SureWest noted in its Comments, while it encourages a framework that is responsive to market needs and will reduce arbitrage, it does not see an immediate need for all ILECs to move to a *single* national rate over a short period of time. That objective may help to reduce administrative costs for some ILEC carrier customers, and may promote some other beneficial goals, but it ignores the essential ratemaking scheme incorporated into the Act – which is based on cost-based pricing designed to allow an individual carrier to recover its costs. The ability of an ILEC to adjust rates is essential, and that ability differs greatly from the ability of that ILEC to have residual ARM recovery adjusted. A single unified rate would demonstrably eliminate the opportunities for cost recovery by some ILECs and would ultimately inflate the burden to be shouldered by any ARM mechanism.

While there is merit in some portions of the BellSouth proposal, it remains grounded in the needs of BellSouth as a large price cap carrier. It appears premised on getting to a level of intercarrier rates needed to deal with competitive forces in its large urban centers and other areas, and to unwind some of the anomalies that have been created with reciprocal compensation that penalize it and other large ILECs, uniquely. While SureWest does not oppose this outcome for BellSouth, a reduction in access rates of the size suggested by BellSouth is not needed by SureWest to address competitive issues in its service areas. SureWest agrees reciprocal compensation rates should move to or toward B&K because it is exclusively local.

Of particular significance for SureWest is the fact that BellSouth did not independently look at carrier classifications. Under this plan, small carriers would still require more gradual transition periods, and perhaps the ability to maintain higher (or different) access rates over a longer period. BellSouth appears to have simply copied, for the initial outlines of its plan, the Covered Rural Telephone Company ("CRTC") concept used in the ICF plan. SureWest has already commented on that definition and its defects. Any definition of the group of ILECs who require a period of higher access rates with additional pricing flexibility must also include the small rate of return carriers who do not fit within the ICF's CRTC definition, such as SureWest and North State Telephone (North Carolina).

To address that critical issue, a “patch” to the CRTC definition is needed wherever it is used, both to protect the customers of those ILECs who have been left out, and also to eliminate the unneeded complexity of the ICF’s dual ARM structure. Thus, SureWest recommends that any future use of the ICF’s privately-negotiated definition include within its coverage either: (a) *all NECA subset 2 and 3 companies; or* (b) *all ILECs that operate in a single state and serve fewer than 300,000 access lines.* The former option reflects current USTA policy in this area. The latter is more focused on the known ILECs omitted from the CRTC definition. *See Attachment 1*. If the Commission should elect to be more focused, then it will have to use a number that addresses the needs of all customers of the small rate of return carriers who are now outliers. The number should be a number between 300,000 and 500,000 lines, to cover the known rate of return carriers and to accommodate the possibility of acquisitions of exchanges by these carriers in the future. In no case should the threshold be less than 250,000 lines. (Of course, if the Commission should elect not to use the CRTC definition and to establish one of its own, coverage of these rate of return carriers and their customers remains essential in any event.)

Taking the BellSouth proposal as it was made, SureWest estimated that its operations would incur a significant loss of access revenues that would be otherwise unrecoverable through SLC changes, other rates or USF support flows. For that reason, it cannot support this proposal in its current form.

Although this is not proposed as a separate proposal, it is believed that much of the adverse impact of this plan on smaller carriers could be reduced through a series of steps:

- Phase I - There should be a five year plan, with only one phase. No carrier can easily predict its own strategic needs beyond 3-5 years; thus, it would appear to be futile to attempt to put in place the details of a plan for the entire industry that would be implemented over a longer period. The Commission could revisit the issues after four years. If circumstances changed dramatically, the option to accelerate or to adjust is always present.

- Phase I Compensation Rates – The Commission could reduce the lower of intrastate and interstate switched access rates for ILECs that are not in Subset 1 or another large carrier grouping at a more moderate pace than for the larger companies – perhaps to $.02 in year 1[1], to $.015 in year 2, to $.0125 in year 3, and be held at $.01 per minute in year 4, pending review of any next steps that are required. Simultaneously, reciprocal compensation should be able to trend downward. The Commission also could seek avenues for jurisdictional unification that are not abrupt. This will accomplish the primary goal to reduce arbitrage, while allowing smaller carriers to recover their costs and to maintain the high quality network expected by both interconnecting carriers and end-users. All carriers should have additional pricing flexibility to deal with intrastate and interstate switched access rates in more competitive markets.
- Phase I SLCs -- SLC cap increases through year 5 could be more carefully measured, and perhaps limited to $.50-.60 per year, with inflation indexing thereafter. These end user revenue increases would not test price elasticity to the same degree as other plans, but would clearly help to offset a portion of the impact of the reduction in switched access revenues.
- ICLS cost recovery – Regardless of SLC modifications, carrier recovery from the current ICLS should not be decreased below present levels. The ICLS fund distributions currently are based on SLC earnings by a recipient carrier. ICLS fund distributions should be divorced from SLC levels in the future. If the phase-in of any SLC level increases were to result in an equal reduction of the ICLS, then the SLC increases would

[1] The proposed rate of $.02 is based on the current interstate composite switched access charge rate of approximately $.02 per minute for rate of return carriers participating in NECA pools. See John Staurulakis Comments at page 13.

fail to provide the necessary cost recovery required to help offset the loss of switched access revenue.

- A residual revenue fund such as an ARM remains essential to allow carriers the opportunity to recover their otherwise-unrecovered costs. It should be structured to be as small as practicable, and not to distort other surviving avenues of ILEC cost recovery. (Under the suggestions here, the ARM could be significantly smaller than ARMs under the ICF Plan or the BellSouth proposal.) There are numerous ARM-like structures that could fit the BellSouth proposal with some modification and provide the necessary cost recovery, thus protecting the carrier's ability to fulfill its service obligations to interconnecting carriers and end users. However, the Commission should reject any new definitions for USF cost recovery under alternative cost recovery mechanisms, or ARMs, unless they address all affected ILECs and the impacts on their customers in a consistent manner.
- Phase II – Work only on Phase I for now, and do not prejudge what should be done in any Phase II. Revisit the impacts of Phase I after a period of about four years, and then determine the appropriate action to be taken.

IV. OTHER COMMENTS.

Three areas of general concern appear in the comments that should be addressed in the context of any action taken in this proceeding. One relates to the handling of 800 and similar services. The second relates to the need for using local rate benchmarking. The third relates to the need to retain, to the extent practicable, policy suggestions made by small rural and rate of return carriers to assure that their customers will not be prejudiced by action in this proceeding.

The Commission should permit the continued recovery of the costs of 800 and similar 8XX calls from the recipients – the called parties. No B&K scheme should alter this policy.

TDS Telecom states in its Comments, at 21: “A key argument cited by bill-and-keep proponents to justify recovering origination and termination costs from end-users is that both the calling *and* called party benefit from the exchange of calls and should jointly bear their costs. Toll-free calling, however, is intended to offer benefits to the calling party on a cost-free basis. Accordingly, the costs of originating toll-free calls should not be recovered from originating end-users, but from the recipients of toll-free calls (through the carrier that has a retail relationship with the toll-free number operator).” This would continue to have value in any future ratemaking environment.

The Commission should evaluate the benefits of establishing a composite nationwide local rate benchmark or benchmarks. While not necessarily simple to measure, local rate benchmarks using consistent elements can help to eliminate or offset rate disparities and their indirect impacts, including claims that USF and other support mechanisms are skewed due to state- or carrier-specific ratemaking. On balance, it will be a tool to gain added fairness for payers of support throughout the U.S. It would have special value in the development of an ARM mechanism. See, *e.g.*, Rural Alliance Comments at page 13. Under the Rural Alliance plan, carriers with basic local rates above the nationwide benchmark would be allowed to reduce local rates and draw replacement funding for the difference. Carriers with rates that are too low should be able to modify local rates accordingly.

Finally, discussions within USTelecom have identified a range of substantive ratemaking items that were the subject of discussion between large and small carriers, and between ILECs and other carriers, and that appear to be settled as valuable components of any future plan that would help provide “universal service insurance”. Such items include, for example, use of historic rather than forward-looking costs, establishing a touchstone date for establishing the cost basis of ILECs at July 1, 2005, and making any ARM fund non-portable.

V. CONCLUSION.

The issues faced by SureWest and many other carriers in this proceeding are unique and complicated. Any Commission action in this proceeding is likely to have significant impacts upon these carriers' continued ability to meet their common carrier obligations. The Commission should continue to look for industry-based solutions that reflect a truly balanced approach that deals with the unique concerns of ILECs as well as other affected carriers.

Respectfully submitted,

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ATTACHMENT 1

1. Definition of Covered Telephone Company ("CTC")

For the purposes of this plan, a "Covered Telephone Company" is an ILEC that, as of July 1, 2005, and excluding those exchanges that are subject to the provisions for acquired exchanges, below, (a) meets the definition of a "Rural Telephone Company" in Section 3(37) of the Communications Act of 1934, as amended, 47 U.S.C. § 153(37), and is not a Bell Operating Company or affiliate thereof, and, in such study areas ("COSAs"), serves fewer than one million access lines; or (b) qualifies as a two percent carrier under the criteria established in Section 251(f)(2) of the Communications Act, 47 U.S.C. § 251(f)(2) with a holding company average of fewer than 19 switched access end user common lines per square mile; or (c) operates in a single state and serves fewer than three hundred thousand access lines. A CTC shall not be treated as a CTC with respect to customers it serves outside its ILEC serving area. To determine whether it meets the definition of a "Covered Telephone Company" under this section, a carrier shall presumptively be entitled to rely on the categorization published by the Universal Service Administrative Company for purposes of distributing high cost universal service support as one means of qualification, and on access line numbers reported to the National Exchange Carrier Association.

<u>Impact:</u>

This uses the ICF Plan definition as a baseline. Up to three carriers could be affected by this addition: SureWest Telephone (CA) (~130K lines), North State Telephone (NC) (~130K lines), and perhaps Anchorage Telephone (AK) (~170K lines). The ceiling accommodates possible impacts of acquired exchanges.

Alternative. Definition of Covered Telephone Company ("CTC")

For the purposes of this plan, a "Covered Telephone Company" is an ILEC that, as of July 1, 2005, and excluding those exchanges that are subject to the provisions for acquired exchanges, below, (a) meets the definition of a "Rural Telephone Company" in Section 3(37) of the Communications Act of 1934, as amended, 47 U.S.C. § 153(37), and is not a Bell Operating Company or affiliate thereof, and, in such study areas ("COSAs"), serves fewer than one million access lines; or (b) qualifies as a two percent carrier under the criteria established in Section 251(f)(2) of the Communications Act, 47 U.S.C. § 251(f)(2) with a holding company average of fewer than 19 switched access end user common lines per square mile; or (c) is a rate of return ILEC in National Exchange Carrier Association Subset 2 or 3. A CTC shall not be treated as a CTC with respect to customers it serves outside its ILEC serving area. To determine whether it meets the definition of a "Covered Telephone Company" under this section, a carrier shall presumptively be entitled to rely on the categorization published by the Universal Service Administrative Company for purposes of distributing high cost universal service support as one means of qualification, and on access line numbers reported to the National Exchange Carrier Association.

<u>Impact:</u>

It is believed this would have the same impact as the other definition. This language is closer to current USTA policy.